IN THE

Supreme Court of the United States

October Term, 1966

No. 490

AMERICAN MANUFACTURERS MUTUAL INSURANCE CO., AMERICAN MOTORISTS INSURANCE CO., FEDERAL MUTUAL INSURANCE CO., and LUMBERMENS MUTUAL CASUALTY CO.,

Petitioners,

against

AMERICAN BROADCASTING-PARAMOUNT THEATRES, INC.,

Respondent.

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

POINT I

Respondent incorrectly states the issue to be whether the contract is illegal on its face.

ABC phrases its version of the "question presented" in terms of whether "the contract is not on its face or in itself an agreement in restraint of trade * * *." The argument is then repeatedly made (*e.g.*, pp. 7, 8, 9, 13, 15, 21, 22, 24, 36, 40) that a contract is not inherently illegal unless the illegality appears "on its face."

Carefully omitted from ABC's statement of the "question presented" is any reference to the controlling test stated by this Court in *Kelly* v. *Kosuga*, 358 U. S. 516 (1959) and in *Continental Wall Paper Co.* v. *Louis Voight & Sons Co.*, 212 U. S. 227 (1909): that the contract is unenforceable where its enforcement would "make the courts a party to the carrying out of one of the very restraints forbidden by the Sherman Act" (358 U. S. at 520). This Court has also stated that a contract is enforceable if it is "collateral" to the illegality, but not if the illegality is "inherent" or "intrinsic" in the contract, and not if the contract is an "essential" part of the "illegal scheme" (*Continental Wall Paper Co.* v. *Louis Voight & Sons Co.*, 212 U. S. 227, 260-261 [1909]; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 551 [1902]; *D. R. Wilder Mfg. Co.* v. *Corn Products Co.*, 236 U. S. 165, 173, 177 [1915]; *A. B. Small Co.* v. *Lamborn & Co.*, 267 U. S. 248, 252 [1925]).

In short, ABC has opposed this application for certiorari by resting on the fallacious proposition that a contract can be enforced unless the illegality appears "on its face."

POINT II

The test of enforceability of a contract is whether it "carries out" the antitrust violation.

Despite ABC's constant repetition of its contention that the contract in this case is not illegal "on its face", not a single one of the authorities relied on by ABC has enforced an inherently illegal contract simply because the illegality

does not appear on its face. Nor is there a single decision that lays down a rule that the contract is enforceable if the illegality does not appear on its face. In neither the *Continental* case nor in *Associated Press* v. *Taft-Ingalls Corporation,* 340 F.2d 753 (6th Cir. 1965), *cert. denied* 382 U. S. 820 (1965) did the illegality appear on the face of the contract. ABC's brief misstates both of these cases. In both of those cases the contract was held inherently illegal because to enforce the contract would be to carry out the restraint. This reply brief will deal with these misstatements of ABC at greater length below.

To enforce an inherently illegal contract simply because the illegality does not appear on its face defies logic and policy. It stands on no rational basis. It would be a triumph of form over substance. If the "on its face" test were adopted, parties to virtually every unlawful agreement would be able to make the contract enforceable by simply embodying the unlawful term in some other document or by making it the subject of an oral agreement. In the contract in suit, for example, it was only necessary to omit from the contract any evidence that the 35 stations were unwanted to keep the fact of illegality from appearing on the face of the contract.

Numerous decisions of this Court have made clear that a contract is unenforceable if antitrust illegality "inheres" or is "intrinsic" in the contract, or if the contract would "carry out" the antitrust violation. It makes no difference that the fact of illegality does not actually appear on the face of the contract. See *e.g., Kelly* v. *Kosuga,* 358 U. S. 516 (1959).

ABC's labored treatment of *Kelly* v. *Kosuga*, 358 U. S. 516 (1959), carefully omits reference to the controlling elements in that decision. At page 21 ABC states that "it was extremely difficult to separate the illegal part of the contract—the non-delivery agreement—from the legal part of the contract * * *." In fact, the non-delivery agreement, i.e. to withhold onions from the futures market, was oral, and was not incorporated by reference or otherwise in the written memorandum of the purchase agreement upon which suit was based. Thus, the key non-delivery term, on which the claim of illegality was predicated, was not even contained in the written contract.

Moreover, it is most significant that in the *Kelly* case the defendant, who was trying to avoid the contract, was an inducing cause of the antitrust restraint. There, Kelly wanted Kosuga to withhold Kosuga's onions from the futures market. In the instant case Kemper did not want the tie-in. ABC was the inducing cause of the restraint. Kemper was the victim.

Furthermore, in the *Kelly* case the restraint (the withholding of goods from the futures market) did not impinge on the defendant buyer who was resisting enforcement of the contract of sale on antitrust grounds. Thus enforcement of the contract of sale for the onions against the purchaser did not in any way subject the purchaser to the impact of the restraint of trade. That case is in marked contrast with the instant case. Here the restraint (the tying of different products together) adversely impinges directly on the purchaser, Kemper, as well as on others (see pp. 13-18, Kemper's petition). Thus, this case is a classic in-

stance where to enforce the contract would be to carry out the "very restraints forbidden by the Sherman Act" (*Kelly* v. *Kosuga*, 358 U. S. 516, 520 [1959]).

In its discussion of *Continental Wall Paper* v. *Louis Voight & Sons Co.*, 212 U. S. 227 (1909), at pages 12 and 13 of its brief, ABC incorrectly assumes that suit was brought on the price-fixing agreement, i.e. the requirements contract, which ABC correctly but irrelevantly notes was "illegal on its face". Suit was not brought on the price-fixing agreement. Suit was brought on sales accounts that were made up with reference to, and in execution of, the illegal combination (212 U. S. at 261-262) and which contained neither of the restrictive provisions referred to by ABC at page 12 of its brief. Thus, the sale contracts in the *Continental Wall Paper* case were not illegal on their faces, but were nevertheless inherently or intrinsically illegal because they were made up "with direct reference to and in execution of" the illegal price-fixing conspiracy (212 U. S. at 261-262).

In the other decisions of this Court, relied on by ABC, this Court enforced the contract only on a holding that the contract was "collateral" or "intrinsically legal" (*Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 551 [1902]; *D. R. Wilder Mfg. Co.* v. *Corn Products Co.*, 236 U. S. 165, 173, 177 [1915]; *A. B. Small Co.* v. *Lamborn & Co.*, 267 U. S. 248, 252 [1925]).

In *Bruce's Juices, Inc.* v. *American Can Co.*, 330 U. S. 743 (1947) the Court held that "the violation, if there was one, is not inherent in the contract sued upon, * * * *but can only be found in different transactions which a party to the*

litigation had with third persons who are not parties'' (330 U. S. at 755-756, emphasis added).

ABC misstates *Hammond Ford, Inc.* v. *Ford Motor Co.*, 39 F. R. D. 604 (S. D. N. Y. 1966) at page 24 of its brief in an attempt to show that District Judge Bonsal recognized the test of illegality ''on its face'' and equated it with illegality ''in itself''. In fact, Judge Bonsal said no such thing, but noted that with sufficient proof a tie-in might be established by a ''course of conduct'' (39 F. R. D. at 606). Moreover, he held that the issues concerning Ford's conduct in enforcing the agreement ''require a trial for their resolution'' (*id.*).

The cases of *Sola Electric Co.* v. *Jefferson Co.*, 317 U. S. 173 (1942), *Katzinger* v. *Chicago Metallic Mfg. Co.*, 329 U. S. 394 (1947), and *MacGregor* v. *Westinghouse Co.*, 329 U. S. 402 (1947) also applied the test of intrinsic or inherent illegality, rather than the test of whether the fact of illegality appears on the face of the contract. At page 41 of its brief ABC takes issue with Kemper's statement that in each of these cases ''the illegality turned on the extrinsic fact that the patent was invalid.'' ABC's contention is that the agreements in these cases contained price-fixing clauses which were in themselves illegal. ABC overlooks the point that under the rule of *United States* v. *General Electric Co.*, 272 U. S. 476 (1926) a patentee could lawfully fix the price of his patented article. It was only on a showing of patent invalidity, an extrinsic fact, that the agreements became inherently illegal.

It is apparent from the overwhelming weight of this authority, including the decisions relied on by ABC, that no

court has ever before adopted the rule now urged by ABC that a contract may be enforced as long as the fact of its illegality does not appear on its face. The true test is whether the illegality inheres in the contract so that enforcement of the contract would carry out the illegal restraint. In the present case the illegal restraint not only required Kemper to take what it did not want, but obviously the effect of enforcing the contract is to impinge directly on Kemper. Kemper was not the inducing cause of the tie-in. Kemper was the victim. That the unlawful tie-in inheres in the contract is obvious, because the contract is itself the tie-in agreement, and specifies both the unwanted and wanted products.

POINT III

Kemper cannot get full relief unless the issue of inherent illegality is resolved before ABC's judgment is enforced.

ABC argues in Point II that certiorari should be denied because the state court decision and judgment do not preclude Kemper from obtaining "full relief" in the suit now pending in the federal District Court.

Kemper's primary relief from a contract inherently illegal under the antitrust laws is to bar enforcement of the contract. This is the most direct, simple and effective remedy. It has been the remedy prescribed from the inception of the doctrine of inherent illegality. As early as the *Continental* case, this Court made it clear that enforcement of the contract "* * * is denied, not for the benefit of the defendant, but because public policy demands that it

should be denied without regard to the interests of individual parties'' (*Continental Wall Paper Co.* v. *Louis Voight & Sons, Co.*, 212 U. S. 227, 262 [1909]; *United States* v. *Bayer Company*, 135 F. Supp. 65, 72-73 [S.D.N.Y. 1955]).

The availability of a treble damage remedy is completely immaterial to the remedy of unenforcement (*Associated Press* v. *Taft-Ingalls Corporation*, 340 F. 2d 753 (6th Cir. 1965), *cert. denied* 382 U. S. 820 [1965]). In the *Associated Press* case the Court of Appeals denied Taft-Ingalls' counterclaim for treble damages while simultaneously refusing to enforce the contract. It is, therefore, plain that ABC is clearly wrong in asserting that the availability of a treble damage remedy in the District Court means that Kemper could get ''full relief'' in the District Court suit. Treble damages could never afford complete relief in a case involving a contract inherently illegal for antitrust reasons, because such a remedy would not, as effectively as nonenforcement, vindicate the public interest or policy recognized in *Continental Wall Paper* which dictates the nonenforcement of such contracts.

It is thus clear that the capacity of the District Court here to award treble damages is not the equivalent of affording Kemper ''full relief''. On the contrary, if the state court decision is allowed to stand, Kemper will be deprived of ''full relief''.

While ostensibly deferring the antitrust issue to the federal District Court the state court, by executing its judgment, will effectively foreclose the federal court from awarding Kemper its primary relief, i.e., barring the enforcement of the inherently illegal contract. Indeed, denial

of certiorari at the present posture of this case and collection of the judgment would effectively and irrevocably dispose of the issue of enforceability without any court having adjudicated the question on its merits. The decision of Special Term, Part I, does not decide that the contract is not inherently illegal. It goes no further than stating that the applicable test, i.e., whether enforcement would carry out the restraint, is not free from ambiguity in its application to this case. The emphasis in the decision on the inappropriateness of the state court as a forum for resolving the antitrust issue, on the appropriateness of the federal forum for resolving the antitrust issue, and the emphasis on the pendency of the federal suit are completely irrelevant to the substantive issue of inherent illegality. The court's emphasis of these points merely makes it clear that the decision did not rest on a holding that the contract was not inherently illegal, but rather on the point that the federal issue should be decided in the federal, not state, court.

Until the federal court has actually adjudicated the illegality of the contract it may be reluctant to enjoin the state court proceeding (28 U. S. C. §2283; *Avon Publishing Co.* v. *American News Company,* 143 F. Supp. 516 [S.D.N.Y. 1956]; compare *Studebaker Corporation* v. *Gittlin,* 360 F. 2d 692 [2d Cir. 1966]). Thus the federal court may not grant complete relief unless it enters judgment before the state court has enforced the contract.

We submit that the happenstance of the state court having reached final judgment before the antitrust issue has been resolved by the federal District Court should not be allowed to affect the outcome of the case. The resolution of

the issue of enforceability should not be left to the accident of the calendar position of the parallel state and federal cases. To allow the outcome of a case to turn on such accidental factors involves the very "quality of capriciousness" that the court below was ostensibly seeking to avoid.

POINT IV

Since Kemper has received no benefits from the cancelled sponsorship rights the defense of illegality is consistent with the "overriding general policy" recognized by this Court.

Kemper received none of the sponsorship rights for which ABC now seeks payment. Thus, this is unlike the numerous cases relied on by ABC wherein the plaintiff sought payment for goods sold and delivered. In its brief ABC seeks to suggest that *Kelly* v. *Kosuga,* 358 U. S. 516 (1959) did not involve goods sold and delivered. This Court was of the opposite view, for its opinion stated that "petitioner had in fact purchased the 50 cars of onions" (358 U. S. at 518) and referred to the transaction as a "completed sale" (358 U. S. at 521). ABC makes much of the fact that Kelly took possession of only 13 of the 50 carloads of onions. This Court's opinion shows that the storage charges after the sale were to be paid by the buyer and that Kelly had "withdrawn 13 cars of the onions from the designated storage places *after the sale,* but had not withdrawn the remainder" (358 U. S. at 518, emphasis added). *Thereafter* Kosuga, the unpaid seller, after Kelly's repudiation, "withdrew the remaining cars from storage and sold them for petitioner's account" (*id.*). It is clear from this that the entire 50 carloads had been delivered to the designated

storage areas, and that title had passed to Kelly on delivery in storage. The unpaid seller had merely exercised a right to retrieve the goods and sell them for the buyer's account (*cf.* Uniform Commercial Code §§2-705, 2-706).

That this Court did not treat the *Kelly* case as one involving undelivered goods is, moreover, clear from the rationale of its decision in that case, which is that the "overriding general policy" is one of "preventing people from getting other people's property for nothing when they purport to be buying it" (358 U. S. at 520). Moreover, ABC's quotation from Handler, *Recent Developments in Antitrust Law: 1958-1959,* 59 Colum. L. Rev. 843, 873 (1959), shows that Professor Handler treated *Kelly* as a case involving "goods sold and delivered".

Because the instant case does not involve goods sold and delivered, it should be apparent that Kemper is not asking the Court to provide a sanction not authorized by Congress (see ABC's brief, pp. 16-17, 19). Kemper seeks no forfeiture and is not attempting to penalize ABC by refusing to pay for what it has received. All Kemper seeks in its sixth affirmative defense is to prevent an illegal restraint from being consummated through coerced payment for what was not wanted and what was not received.

POINT V

The conflict with *Associated Press* v. *Taft-Ingalls Corporation*, 340 F.2d 753 (6th Cir. 1965), *cert. denied* 382 U. S. 820 (1965) should be resolved.

ABC has stated (brief, p. 35) that the conflict between the decision of New York's highest court in this action and the decision of the Court of Appeals for the Sixth Circuit in the *Associated Press* case is not a ground for granting certiorari. This assertion is directly contrary to the practice of this Court. In *California* v. *Taylor*, 353 U. S. 553 (1957) this Court stated at page 556:

> "We granted certiorari to resolve the conflict between the United States Court of Appeals and the California Supreme Court as to the applicability of the Railway Labor Act to a railroad owned and operated by a State."

Similarly, in Stern and Gressman, *Supreme Court Practice* (3d ed. 1962) it is stated at page 132:

> "Another valid reason for the granting of certiorari by the Supreme Court is the presence of a direct conflict between the decision of a court of appeals and that of the highest court of a state, where that conflict concerns federal questions."

ABC then attempts to distinguish *Associated Press* on the following grounds: (1) "In the first place, the pleading question here was never raised and the judgment in that case was rendered after a trial on the merits." (2) The case arose in a federal court in which the defendant counterclaimed for treble damages. (3) Illegality in the *Asso-*

ciated Press contract, allegedly, did appear "on the face" of the contract. (4) Disallowance of the defense would, allegedly, have caused an "extreme hardship." None of these attempted distinctions has the slightest merit.

(1) Obviously the question of validity of the contract was raised in *Associated Press.* The fact that there was no "trial on the merits" in this case, as there was in *Associated Press,* is the result of the erroneous decision below striking the affirmative defense.

(2) If enforceability of an illegal contract were to turn on the forum in which enforcement is sought, this would lead to forum shopping of the worst kind. The problem of "multiplicious" (*sic*) litigation should be resolved by an appropriate stay of the state court action until the antitrust issues have been resolved in the federal court.

(3) The illegality of the tie-in feature of the *Associated Press* contract most assuredly did not appear "on the face" of the Associated Press-Taft-Ingalls contract. Moreover, the By-laws which were incorporated by reference in the contract said nothing about one wire service being tied to another. They merely referred to "a leased wire news service" which the parties at trial stipulated consisted of three wires. The requirement that Taft-Ingalls take the fourth wire, the Kentucky wire, was not specified in the contract, on ABC's theory of what the contract required (brief, p. 37). Even if one contract had expressly obligated Taft-Ingalls to take the four wires, it would be no different from the instant contract which expressly obligated Kemper to take the 35 unwanted stations as well as the 95 wanted stations. If the *Associated Press*

contract was illegal "on its face", then so was the sponsorship agreement here. In neither case did it appear on the face of the contract that certain of the services therein provided for were unwanted. Moreover, the Court of Appeals relied on numerous extraneous facts to show that Taft-Ingalls did not want each of the four wire services and that Associated Press would not allow it to purchase only the desired services (340 F. 2d at 757-759, 766).

(4) It is difficult to see how Taft-Ingalls was caused any "extreme hardship" not present here. ABC sued Kemper for more than twice the amount Associated Press sued for. It seems obvious, in fact, that Taft-Ingalls' hardship was the lesser one. Taft-Ingalls could have required its successor to subscribe to the four wire services, a stipulation which its contract with Associated Press expressly required it to make. Kemper, on the other hand, was not permitted, under the terms of its contract, to resell the time made available by its termination of sponsorship.

ABC also makes the point (at p. 36): "A disallowance of the defense in that case clearly would have been anomalous and illogical because of the presence of the counterclaim * * *." ABC fails to note, however, that the antitrust defense was upheld even though the counterclaim was dismissed on the merits.

POINT VI

The tie-in effected here is indistinguishable from the "must buy" practice.

At pages 31-34 of its brief ABC asserts that the "must buy" practice is not involved here, because there was no absolute requirement but only a price differential inducing Kemper to take and pay for unwanted stations. ABC then attempts to justify its price differential.

This Court has already recognized in *United States* v. *Loew's Inc.*, 371 U. S. 38, 54-55 (1962), that a tie-in is illegal where a price differential "has the effect of conditioning" the sale of one item on the sale of another. Similarly, District Judge Cooper said in the federal case:

> "Even if plaintiffs were not required to take the additional 35 stations, but would be forced, if they chose not to, to pay a disproportionately high rate for the 95 stations, this too would constitute a violation." (31a)

POINT VII

Kemper's defense is not simply an attack on ABC's network system but is based on the illegality inhering in a tie-in contract.

ABC attempts to avoid the obvious impact of the test of inherent illegality by urging this Court that Kemper, in its sixth affirmative defense, "has attacked the basic foundations of television network broadcasting" (p. 5) and that Kemper's contention "in essence" is that plaintiff's "gen-

eral business is illegal" (p. 11). The same argument is repeated elsewhere in ABC's brief (*e.g.*, pp. 6, 14, 15). Thus ABC seeks to minimize the allegations of the answer relating to the tie-in of 35 stations to 95 stations (*e.g.*, 87a), and to characterize Kemper's answer as basically an attack on ABC's contracts with its affiliates. Precisely the opposite argument was made by ABC in the United States District Court, when ABC sought to strike the allegations relating to affiliates as irrelevant (32a). District Court Judge Cooper disposed of this argument by stating:

> "Even if the contracts between ABC and its affiliates do not constitute a tying agreement giving Kemper a cause of action, the allegations certainly have some bearing on the issues, even if only to demonstrate the economic power and leverage that ABC was able to exercise to control the tie-in." (33a)

Judge Cooper recognized that Kemper was asserting that the tie-in of 35 stations to 95 stations was illegal.

POINT VIII

Duplicate trials may be avoided by a stay of the state court action.

In its brief ABC alluded to the burden to ABC of "litigating the identical antitrust issues in two different courts" if Kemper's defense is upheld (brief, p. 29). As has already been shown in Kemper's petition (p. 28) the solution to this problem is for the state court to stay further proceedings until the antitrust issues have been resolved in the federal court. This is precisely the relief suggested by the New York Court of Appeals in an earlier case (*General*

Aniline and Film Corp. v. *Bayer Co.*, 305 N. Y. 479, 485 [1953]), and it is in some respects comparable to the "abstention doctrine" followed by this Court (*England* v. *Medical Examiners*, 375 U. S. 411 [1964]).

POINT IX

Other misstatements contained in ABC's brief

First, at page 6 of its brief ABC states that the contract involved in this action was "not before the District Court." Although the contract was not attached to Kemper's federal court pleading it was expressly referred to in the pleading, and one of Kemper's prayers for relief asked "That the alleged contract on which is based the suit by ABC against Kemper and Frank in the Supreme Court of the State of New York, County of New York, be adjudged, declared and decreed in violation of section 1 of the Sherman Act, and unenforceable, illegal and of no force and effect." District Judge Cooper denied ABC's motion to strike this prayer from the complaint (34a).

Second, ABC then proceeds to state at page 6 that the "only issue to be decided" in the federal court action concerned "the structure of the television industry * * *" and the negotiations prior to the contract. Judge Cooper never held that this was the "only issue." ABC's effort is apparently to convince this Court that the contract in suit is collateral to the illegality. We respectfully submit, however, that it is abundantly clear that the sixth affirmative defense alleges that the contract itself is an illegal tie-in contract (*e.g.*, answer ¶75; 87a).

Third, ABC is also in error in stating that District Judge Cooper did not hold that Kemper's federal complaint alleged a *per se* violation (brief, pp. 2, 7). That Judge Cooper did hold the allegations sufficient to constitute a *per se* violation is clear from the following extract from his opinion:

> "Defendant again relies on Times-Picayune for the proposition that there must be a monopoly power or dominance over the tying product in order to constitute a per se violation. However correct this interpretation of Times-Picayune may be, its effect was vitiated in Northern Pacific where the Supreme Court said 356 U. S. at p. 11, 78 S. Ct. at p. 521, 2 L.Ed. 2d 545:
>
> > "'While there is some language in the Times-Picayune opinion which speaks of "monopoly power" or "dominance" over the tying product as a necessary precondition for application of the rule of *per se* unreasonableness to tying arrangements, we do not construe this general language as requiring anything more than sufficient economic power to impose an appreciable restraint on free competition in the tied product.'" (p. 30a)

We submit that this can only be read as a statement that Kemper need not prove ABC had monopoly power over the tying products in order to establish a *per se* violation. The correctness of Judge Cooper's decision is supported by the numerous decisions of this Court declaring tie-in agreements to be *per se* violations of the Sherman Act (*United States* v. *Loew's Inc.,* 371 U. S. 38 [1962]; *Northern Pacific R.R. Co.* v. *United States,* 356 U. S. 1, 11 [1958]; *Atlantic Refining Co.* v. *F. T. C.,* 381 U. S. 357, 371 [1965]; *Times-Picayune Publishing Co.* v. *United States,* 345 U. S. 594 [1953]).

Fourth, page 8 of ABC's brief contains a parenthetical statement calculated to suggest that Special Term below actually held that enforcement of the contract "would not make the court a party to carrying out an illegal restraint of trade." Special Term made no such holding. On the contrary, Special Term recognized the appropriate test, i.e., whether enforcement would carry out the restraint, and then failed to apply it (3a-5a).

Conclusion

For the reasons given, it is respectfully submitted that the writ of certiorari should be granted.

Respectfully submitted,

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